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No. 96-2036

In the Supreme Court of the United States

OCTOBER TERM, 1996

WILLIAM WINSTON WAUGH, PETITIONER

v.

INTERNAL REVENUE SERVICE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the three-year priority period established in Section 507(a)(8)(A)(i) of the Bankruptcy Code runs during the pendency of a bankruptcy proceeding.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A10) is reported at 109 F.3d 489. The opinion of the district court (Pet. App. A11-A27) is unofficially reported at 76 A.F.T.R.2d 95-7059. The opinion of the bankruptcy court (Pet. App. A28-A34) is unofficially reported at 75 A.F.T.R.2d 95-2601.

JURISDICTION

The judgment of the court of appeals was entered on March 26, 1997. The petition for a writ of certiorari was filed on June 24, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. On April 15, 1988, petitioner filed his federal income tax return for the taxable year 1987 but failed to pay the tax due. On July 1, 1988, petitioner filed a petition for relief under Chapter 13 of the Bankruptcy Code. The bankruptcy case was subsequently converted to proceedings under Chapter 11. The bankruptcy court initially confirmed petitioner's Chapter 11 plan but later revoked it (because petitioner failed to make child support and alimony payments in accordance with the plan) and dismissed petitioner's case. Petitioner appealed to the district court from the order of revocation and dismissal. Petitioner was granted a stay pending that appeal. From July 1, 1988 (the date that petitioner filed his petition) until February 6, 1991 (the date the district court affirmed the bankruptcy court's order dismissing the bankruptcy case), the government was prevented from taking any action to collect petitioner's 1987 tax liabilities by (i) the automatic stay provided by Section 362 of the Bankruptcy Code (11 U.S.C. 362(a)(6)), (ii) the provisions of the confirmed reorganization plan and (iii) the stay pending appeal from the order of dismissal. Pet. App. A2.

b. On May 9, 1991, petitioner filed a second petition for relief, this time under Chapter 7 of the Bankruptcy Code. Under the provisions of this Chapter, he was granted a discharge on August 27, 1991. Pet. App. A2.

2. On April 2, 1994, petitioner filed his income tax return for 1993. He directed that his income tax refund of $11,019 for that year, plus an additional cash payment of $847 that he remitted with his return, be applied by the Internal Revenue Service against his

outstanding 1989 tax liability. The Service, however, instead applied the 1993 tax refund and the cash remittance to petitioner's still unsatisfied 1987 tax liability. The Service also sent notices advising petitioner of the government's intent to levy on his assets to recover his remaining unpaid income tax liabilities for 1987 ($157,631.36) and 1989 ($15,620.52). Pet. App. A2.

3. In response to these notices of intent to levy, petitioner filed a complaint in bankruptcy court seeking a declaration that his 1987 tax liability had been discharged in his Chapter 7 case. Pet. App. A2-A3.

a. Under Sections 507(a)(8)(A)(i) and 523(a)(1)(A) of the Bankruptcy Code, an income tax obligation of a debtor is entitled to priority status and is not dischargeable if the last day on which the tax return could have been filed falls within three years of the date of the filing of the bankruptcy petition. 11 U.S.C. 507(a)(8)(A)(i), 523(a)(1)(A).[1] Petitioner asserted, however, that, because his 1987 tax return was due on April 15, 1988—a date *more* than three years prior to the filing of his Chapter 7 petition on May 9, 1991—his income tax liability for 1987 was not entitled to priority status in the Chapter 7 proceeding under Section 507(a)(8)(A)(i). If, as petitioner claimed, the tax liability was not entitled to priority status in the Chapter 7 proceeding, it would have been within the scope of the discharge that he received in that proceeding. Pet. App. A2.

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[1] Effective October 22, 1994, Section 507(a)(7)(A)(i) was renumbered Section 507(a)(8)(A)(i). Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, §§ 304(c)(2), 702(b), 108 Stat. 4132, 4150. The provision was otherwise unchanged. Consistent with the decisions below, we use the new section number throughout this brief.

The government contended, however, that the three-year priority period of Section 507(a)(8)(A)(i) was extended by the period of time that the government was prevented by petitioner's first bankruptcy case from collecting his 1987 taxes. The priority period therefore would not have expired before petitioner filed his second bankruptcy case, and those taxes therefore would not have been within the scope of the discharge received in that proceeding. Pet. App. A3.

b. The bankruptcy court agreed with the government's position. The court stated that a "literal reading and 'plain meaning' approach to the Bankruptcy Code, seems to indicate that [an] income tax liability of a debtor who has filed a return, which is last due more than three years before the filing of a bankruptcy case, is not covered by the nondischargeability provision of 11 U.S.C. § 523(a)(1); even where the same tax debt was involved in an earlier bankruptcy case as a nondischargeable tax liability falling within the three year period" (Pet. App. A31). The court noted, however, that nearly every reported decision holds that the "running of the tax priority periods fixed in 11 U.S.C. § 507(a)(8)(A) are [*sic*] tolled during pendency of bankruptcy proceedings in which the IRS is stayed from collection efforts to secure payment of the tax" (*id.* at A31-A32). The court concluded that these decisions, "clearly driven by perceptions of Congressional intent, Bankruptcy Code purpose, and underlying public policy," are correct and "reflect a near universal agreement on the state of the law" (*id.* at A32-A33). Applying the holdings of these cases to the facts in the present case, the court held that "[d]ebtor's income tax liability for the 1987

taxes was not dischargeable in his May 9, 1991, Chapter 7 bankruptcy case" (*id.* at A33).

4. The district court affirmed. The court stated that the literal terms of the applicable statutes do not suspend the running of the priority periods of Section 507(a)(8)(A) during a prior bankruptcy. The court held, however, that this was the "rare case" in which it was necessary to go beyond the literal language of the statutes (Pet. App. A19). The court explained that under a purely literal construction of the statute, debtors would be able to avoid tax obligations simply by dismissing their first bankruptcy petition after the priority periods of Section 507(a)(8)(A) expired and then filing a second petition shortly thereafter (Pet. App. A19). The court emphasized that, if the priority periods ran during a pending bankruptcy proceeding, the government would not be given the time periods to collect tax liabilities that Congress clearly sought to provide (*id.* at A21). The court noted that the legislative history of these provisions "militates directly against the improperly narrow reading suggested by [petitioner]" (*id.* at A22). Because petitioner's argument "would operate to defeat the purpose of Congress," the court concluded that "[t]he proper result is that the filing of a bankruptcy petition suspends the running of the three-year collection period in determining tax claim priority status, pursuant to 11 U.S.C. § 507(a)(8)(A)(i)" (*id.* at A26).

5. The court of appeals affirmed. The court acknowledged that the "Bankruptcy Code does not contain any provisions which explicitly suspend the priority period of section 507(a)(8)(A)(i) while a debtor is engaged in bankruptcy proceedings" (Pet. App. A6). After examining the structure and history of these

provisions, however, the court agreed with the district court that this was the "rare case" in which the plain meaning of legislation should not be applied in a manner that would frustrate the plain object of the statute to afford the government a three-year period for the collection of taxes (*id.* at A7-A8). The court therefore concluded that "the three-year priority period of section 507(a)(8)(A)(i) is suspended by 11 U.S.C. § 108(c) and 26 U.S.C. § 6503(b) and (h), for the time that the automatic stay prevents the IRS from collecting outstanding tax debts" (*id.* at A8).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Petitioner contends (Pet. 5-9) that the decision of the court of appeals unjustifiably disregards the language of Sections 108(c) and 507(a)(8)(A)(i) of the Bankruptcy Code and Section 6503 of the Internal Revenue Code. Petitioner asserts (i) that Section 507(a)(8)(A)(i) is silent regarding any tolling of the three-year priority period during the pendency of a prior bankruptcy proceeding, (ii) that Section 108(c) of the Bankruptcy Code only extends nonbankruptcy law limitation periods, not the priority periods found in Section 507(a)(8), and (iii) that, while Section 6503(h) of the Internal Revenue Code suspends the statute of limitations for the assessment or collection of taxes when the government "is prohibited by reason of [a bankruptcy] case" from assessing or collecting taxes (26 U.S.C. 6503(h)), that statute does not expressly apply to the three-year priority period of Section 507(a)(8)(A)(i). Petitioner further claims that

this is not one of those "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters" (*United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989)).

As the Tenth Circuit concluded in *In re Richards*, 994 F.2d 763 (1993), however, these statutory provisions are not alone controlling. Authority to suspend the three-year priority period of Section 507(a)(8)(A)(i) can be found in a different statutory provision, Section 105(a) of the Bankruptcy Code. See 994 F.2d at 765. That Section provides bankruptcy courts with the authority to issue orders "necessary or appropriate to carry out the provisions of [the Bankruptcy Code,] * * * to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. 105(a). Applying Section 105(a) in *United States* v. *Energy Resources Co.*, 495 U.S. 545, 549 (1990), this Court noted the "traditional understanding" that bankruptcy courts are courts of equity. See also *Pepper* v. *Litton*, 308 U.S. 295, 303-304 (1939). The orders in this case—suspending the three-year priority period of Section 507(a)(8)(A)(i) during petitioner's first bankruptcy case—represent an appropriate application of this equitable power. See 994 F.2d at 765.

As the court of appeals explained (Pet. App. A9-A10), the suspension of the three-year priority period in this case fulfills the statutory design of providing a reasonable time for the government to collect taxes and preventing debtors from escaping liability by shielding their assets in repetitive bankruptcies. As a result of petitioner's first bankruptcy proceeding, the government was precluded from collecting petitioner's 1987 taxes (i) by the automatic stay provisions of Section 362, (ii) by the provisions of peti-

tioner's confirmed plan of reorganization, and (iii) by the stay that petitioner obtained pending his appeal from the order revoking his plan and dismissing his case. Instead of the three years that Congress contemplated in Section 507(a)(8)(A)(i) that the government would have for collecting taxes, petitioner's repetitive bankruptcy filings gave the government only 169 days to do so: (i) the period of 77 days from April 15, 1988, the date the 1987 return was due to be filed, to July 1, 1988, the date the Chapter 13 petition was filed, and (ii) the period of 92 days from February 6, 1991, the date the district court affirmed the bankruptcy court's order of revocation and dismissal, to May 9, 1991, the date the Chapter 7 petition was filed.

Suspending the priority period for collecting taxes under Section 507(a)(8)(A)(i) during petitioner's initial bankruptcy case was necessary to ensure that the government was not deprived of the full benefit of the three years that Congress granted for collection (Pet. App. A9-A10). Accord, *In re Richards*, 994 F.2d at 765; S. Rep. No. 989, 95th Cong., 2d Sess. 14 (1978) ("the tax collector * * * should not lose taxes which he has not had reasonable time to collect or which the law has restrained him from collecting"); S. Rep. No. 1158, 89th Cong., 2d Sess. 3 (1966) (excepting priority taxes from discharge would "discourage recourse to bankruptcy as a facile device for evading tax obligations").[2] As the court explained in *In re Richards*,

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[2] In several related provisions, Congress has evidenced its clear intent to afford the government an opportunity to collect taxes unimpeded by intervening bankruptcy cases. Section 6503(b) of the Internal Revenue Code was already in effect when the Bankruptcy Code was enacted in 1978. It suspends any limitations on the time in which the government may collect taxes during the period that the assets of the taxpayer

994 F.2d at 765, "use of the equitable authority in 11 U.S.C. § 105(a) [to deprive debtors of unintended benefits from repetitive bankruptcy filings] is not inconsistent with any specific provision of the Bankruptcy Code, and * * * is consistent with the underlying philosophy of the Bankruptcy Code."

The court of appeals was also correct in noting that acceptance of petitioner's contrary argument—under which the three-year priority period would continue to run during a prior bankruptcy proceeding—would facilitate schemes of tax avoidance (Pet. App. A10). A debtor could avoid paying his tax debt by filing a petition that stayed collection of taxes, then dismissing his bankruptcy petition after the three-year pri-

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are in the custody or control of any court. See 26 U.S.C. 6503(b). When the Bankruptcy Code was enacted, Congress specified that nonbankruptcy statutes of limitations (such as those contained in the Internal Revenue Code) are suspended until the automatic stay is lifted. 11 U.S.C. 108(c). This provision is intended to "minimize the administrative problems governmental tax authorities face, or may face, in collecting taxes in bankruptcy proceedings." S. Rep. No. 989, *supra*, at 14-15.

Shortly after the Bankruptcy Code was enacted, Congress added Section 6503(h) to the Internal Revenue Code. Bankruptcy Tax Act of 1980, Pub. L. No. 96-589, § 6(a), 94 Stat. 3389. That Section specifically tolls the statute of limitations on assessment and collection of taxes while bankruptcy proceedings are pending. 26 U.S.C. 6503(h). "[I]f the * * * Internal Revenue Service is prohibited for a period of time by reason of a bankruptcy case from assessment or collection of tax (for example, because of the automatic stay under new 11 U.S. Code sec. 362(a)(6)), the running of the period of limitations is suspended, for assessment, for the prohibition period and for 60 days thereafter; and for collection, for the prohibition period and for six months thereafter." S. Rep. No. 1035, 96th Cong., 2d Sess. 50-51 (1980).

ority period expired and then (as petitioner did in this case) filing a new petition shortly thereafter. See also *In re West*, 5 F.3d 423, 426 (9th Cir. 1993), cert. denied, 511 U.S. 1081 (1994); *In re Montoya*, 965 F.2d 554, 556 (7th Cir. 1992). As the Third Circuit stated in *In re Taylor*, 81 F.3d 20, 25 (1996), Congress "did not intend to leave a loophole for debtors to engage in tax avoidance." See also *In re Molina*, 99 B.R. 792, 795 (S.D. Ohio 1988) ("Congress did not intend for a taxpayer to be able to escape liability by protecting his assets in a bankruptcy proceeding until the statute of limitations expired.").

2. a. For these reasons, the courts of appeals have (with only one, limited exception) consistently concluded that the priority periods set forth in Section 507(a)(8)(A) are suspended during the pendency of a prior bankruptcy proceeding. See Pet. App. A8-A9; *In re Taylor*, 81 F.3d at 25; *In re West*, 5 F.3d at 426; *In re Richards*, 994 F.2d at 765; *In re Montoya*, 965 F.2d at 556.[3] In reaching this conclusion, however, the courts have applied different analyses.

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[3] The lower courts have also generally agreed with this conclusion. See, *e.g.*, *Acosta* v. *IRS*, 184 B.R. 544, 547 (W.D. Tenn. 1995); *In re Eysenbach*, 183 B.R. 365, 368 (W.D.N.Y. 1995); *Solito* v. *United States*, 172 B.R. 837, 840 (W.D. La. 1994); *In re Linder*, 139 B.R. 950, 952-953 (D. Colo. 1992); *In re Deitz*, 116 B.R. 792, 794 (D. Colo. 1990); *In re Molina*, 99 B.R. 792, 795 (S.D. Ohio 1988); *In re Brickley*, 70 B.R. 113, 116 (Bankr. 9th Cir. 1986); *In re Shabazz*, 206 B.R. 116, 126 (Bankr. E.D. Va. 1996); *In re McMillan*, 204 B.R. 835, 837-838 (Bankr. M.D. Ga. 1996); *In re Darden*, 202 B.R. 715, 717 (Bankr. E.D. Va. 1996); *In re Cowart*, 199 B.R. 799, 800 (Bankr. M.D. Fla. 1996); *In re Shedd*, 190 B.R. 692, 694 (Bankr. M.D. Fla. 1996); *In re Tibaldo*, 187 B.R. 673, 676 (Bankr. C.D. Cal. 1995); *In re DiCamillo*, 186 B.R. 59, 62 (Bankr. E.D. Pa. 1995); *In re Harris*, 167 B.R. 680, 683 (Bankr. M.D. Fla. 1994); *In re*

Some courts, like the court of appeals in this case, have held that a proper basis for suspending the priority periods of Section 507(a)(8)(A) results from applying Section 108(c) of the Bankruptcy Code, in conjunction with Section 6503 of the Internal Revenue Code, to achieve the clear legislative intent to allow a three-year period unobstructed by any bankruptcy stay of collection. See, *e.g.*, *In re Taylor*, 81 F.3d at 22-24; *In re West*, 5 F.3d at 426-427; *In re Montoya*, 965 F.2d at 557-558. Other courts have relied more directly on the conclusion that the authority to suspend the priority period of Section 507(a)(8)(A) stems from the equitable powers of the bankruptcy court under Section 105(a) of the Bankruptcy Code. See, *e.g.*, *In re Richards*, 994 F.2d at 765; *In re Jones*, 177 B.R. 541, 543-544 (Bankr. N.D. Ohio 1994).

b. Contrary to petitioner's contention (Pet. 4), the decision in this case does not conflict with the decision of the Fifth Circuit in *In re Quenzer*, 19 F.3d 163 (1993). In that case, as here, the government did not

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Teeslink, 165 B.R. 708, 711-712 (Bankr. S.D. Ga. 1994); *In re Bowling*, 147 B.R. 383, 385 (Bankr. E.D. Va. 1992); *In re Ringdahl*, Bankr. L. Rep. (CCH) ¶ 74,082, at 99,718 (Bankr. M.D. Fla. June 5, 1991); *In re Stoll*, 132 B.R. 782, 785-786 (Bankr. N.D. Ga. 1990); *In re Ross*, 130 B.R. 312, 313 (Bankr. D. Neb. 1991); *In re Wise*, 127 B.R. 20, 23 (Bankr. E.D. Ark. 1991); *In re Bryant*, 120 B.R. 983, 985 (Bankr. E.D. Ark. 1990); *In re Davidson*, 120 B.R. 777, 787 (Bankr. D.N.J. 1990); *In re Florence*, 115 B.R. 109, 112-113 (Bankr. S.D. Ohio 1990); *In re Quinlan*, 107 B.R. 300, 301 (Bankr. D. Colo. 1989); *In re Carter*, 74 B.R. 613 (Bankr. E.D. Pa. 1987); contra *In re Pastula*, 203 B.R. 941, 945-948 (Bankr. E.D. Mich. 1997); *In re Macko*, 193 B.R. 72 (Bankr. M.D. Fla. 1996); *In re Turner*, 182 B.R. 317 (1995), adhered to on reconsideration, 195 B.R. 476 (Bankr. N.D. Ala. 1996); *In re Gore*, 182 B.R. 293, 298-299 (Bankr. N.D. Ala. 1995).

contend that the literal terms of Section 108(c) of the Bankruptcy Code and Section 6503 of the Internal Revenue Code tolled the priority periods of Section 507(a)(8)(A). The government contended instead that suspension of the priority period was a proper exercise of the court's authority under Section 105(a) of the Bankruptcy Code. The Fifth Circuit declined to consider that argument, however, because the government had not raised it in the lower courts. 19 F.3d at 165. Because the government had relied exclusively on Section 105(a) on that appeal, the Fifth Circuit merely adopted the government's concession that the literal terms of Sections 108, 507 and 6503 do not themselves compel the suspension of the priority period. *Ibid.*

The court in *Quenzer* therefore did not consider either of the arguments accepted by the various courts that have ruled in favor of the government on this issue. The court in *Quenzer* did not consider the argument, adopted by the court of appeals here, that this is the "rare case" in which "the intention of the drafters, rather than the strict language, controls" (*United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. at 242). Nor did the court in *Quenzer* address the argument adopted in decisions such as *Richards*, 994 F.2d at 765, that the priority periods of Section 507(a)(8)(A) may be suspended under Section 105(a) of the Bankruptcy Code. Instead, the court in *Quenzer* specifically declined to address that question because it had not been raised in the lower courts in that case. 19 F.3d at 165.

A conflict among the circuits thus does not exist on the proper disposition of the question presented in this case. On the issues actually litigated in this case, it cannot be said that the Fifth Circuit would

reach a different result than that reached by the several circuits that have addressed them. Thus, when the same alleged conflict between *Quenzer* and the decisions of the other circuits was raised as a basis for further review in *In re West*, *supra*, this Court denied the petition for a writ of certiorari. 511 U.S. 1081 (1994). Review by this Court is not warranted here for the same reasons.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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